IN THE

Supreme Court of the United States

Docket No. 77-1638

JAMES E. CRANE: JAMES E. CRANE, M.D., P.C.; and JAMES E. CRANE and MARY ELLEN CRANE, Trustees of JAMES E. CRANE, M.D., P.C. PENSION TRUST (on behalf of themselves and investors similarly situated),

Petitioners,

—v.—

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL & HOLLAND: and RITCH, GREENBERG & HASSAN,

Respondents.

BRIEF OF RESPONDENTS RITCH, GREENBERG & HASSAN IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Opinions Below

The opinions of the District Court are annexed to the petition as Appendices D, E, & F.

Court of Appeals affirmed the opinions of the District Court and did not render an opinion of its own.

None of the aforesaid opinions have yet been officially reported.

Jurisdiction

The jurisdictional requisites are set forth in the petition at page 2.

Question Presented

Whether a plaintiff must aver the circumstances constituting fraud with particularity in an action alleging securities laws violations.

Statutes Involved

The pertinent Federal Rules of Civil Procedure are FRCP 8(a) and (e), 9(b), and Form 13 appended to the Federal Rules of Civil Procedure.

The pertinent statutory provisions of the Securities Act of 1933 are Section 5, 15 USC Section 77 E; Section 12(2), 15 USC Section 770(2); Section 13, 15 USC Section 77M; Section 17(a), 15 USC Section 77Q(a).

The pertinent statutory provisions of the Securities Exchange Act of 1934 are §10(b), 15 U.S.C. §78J(b); §15(c), 15 U.S.C. §78O(c); §20(a), 15 U.S.C. §78T(a).

The pertinent rules of the Securities Exchange Commission are Rule 10B-5, 17 CFR 240.10(b)-5 and Rule 15CL-2, 17 CFR 240.15CL-2.

Statement of the Case

1. *Nature of This Action and the Parties*

This action was commenced on November 26, 1975 by the filing of a complaint alleging violations of §17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. § 77q(a), §§ 10(b), 15(c) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), o(c) and t(a), respectively, and S.E.C. Rules

10b, 10b-5 and 15c1-2. The first amended complaint added an alleged violation of Securities Act § 5, 15 U.S.C. § 77e, which was later abandoned. The second amended complaint added an alleged violation of § 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2).

At this juncture plaintiffs are asserting claims only under § 10(b) of the Exchange Act, and §§ 12(2) and 17(a) of the Securities Act. (App. Br. 2)[1] Plaintiffs also have asserted claims, relying on pendent jurisdiction, for reckless, wanton and/or willful acts and representations by defendants; negligent representations, and breach of fiduciary relationship.

The plaintiffs are Dr. James E. Crane, individually, as a trustee of his pension trust and as a professional corporation, and his wife, Mary Ellen Crane, as trustee of Dr. Crane's pension trust. Plaintiffs seek to recover losses allegedly sustained on their limited partnership investments in three real estate tax shelters. The nature and date of purchase of these interests were as follows:

a) A limited partnership interest in Reading-Easton Associates—purchased on November 15, 1972 for $26,000 (17a);[2]

b) A limited partnership interest in Carlene Tower Associates—purchased on June 15, 1973 for $13,000 (*id.*); and

c) A debenture issued by Clementon Associates purchased on January 1, 1974 for $7,500. (*id.*)

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[1] Citations preceded by "App. Br." indicate references to pages in Appellants' Brief.

[2] References designated "__a" are to the pages of the appendix filed by appellants herein.

The defendants are: the corporation which formed the limited partnerships and sold interests therein to the public —Stonehenge Industries, Inc. ("Stonehenge"); the officers and directors of Stonehenge—Messrs. Constantine, Ward and Henderson; Howard N. Garfinkle, who allegedly sold real estate properties to Stonehenge and improperly obtained and misappropriated funds from Stonehenge; the sales representatives of Stonehenge—Grayson Securities, Inc. and Arthur Grayson; and every lawyer and accountant who rendered any professional services to Stonehenge including Ritch, Greenberg & Hassan ("Hassan") certified public accountants; Donald L. Lawrence, an attorney; Leslie A. Barth and Bergman and Barth, P.C., attorneys, and Pierson, Duel & Holland, attorneys.

2. *Prior Motions to Dismiss and Decisions of the Court*

Defendants Hassan and Pierson, Duel & Holland moved to dismiss the original complaint on several grounds including plaintiffs' failure to comply with Fed. R. Civ. P. 9(b) and plaintiffs' failure to state a claim upon which relief can be granted. The original complaint was dismissed on May 27, 1976 with leave to replead. An amended complaint was filed on June 14, 1976 but it was as deficient as the original and new motions to dismiss were filed.

On September 7, 1976 the District Court dismissed the amended complaint as to Pierson, Duel & Holland stating that it failed utterly to set forth a specific fact from which it could be concluded that there was any connection between the defendant law firm and the alleged wrongful conduct and that it lacked the specificity mandated by Rule 9(b).

On September 23, 1976 and November 30, 1976 the amended complaint also was dismissed as to Hassan and

Barth and Bergman and Barth, P.C., respectively, on Rule 9(b) grounds.

Thereafter, plaintiffs moved for reconsideration of the dismissals and for leave to file a second amended complaint. Leave was granted and a second amended complaint was filed on December 20, 1976. That complaint proved to be a rehashed version of its predecessors and defendants were compelled to move once again. This time the District Court granted the motions, with prejudice, noting that although "facially rearranged" (108a) the third complaint contained "no greater specificity than before" (108a). The complaints relating to Hassan, Bergman & Barth and Barth similarly were dismissed on Rule 9(b) grounds.

Since all of these dismissals were based solely on an analysis of the complaint, we respectfully refer to that document alone—not the expanded interpretation found in Appellants' Brief—as the touchstone for this Court's review.[3]

The U.S. Court of Appeals for the Second Circuit affirmed the decision of the District Court without opinion.

Reasons for Denying the Writ as to Defendants Ritch, Greenberg & Hassan

Notwithstanding Plaintiffs' assertion, the decision of the Court below is not in conflict with the decisions of the Courts of Appeal and District Courts in other circuits. The Courts below have consistently applied the require-

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[3] The Second Amended Complaint appears at pages 12a-62a of the Appendix. The discussion *infra* cites two specific paragraphs of the Complaint itself.

ments of FRCP 9(b) to actions alleging securities violations. See, e.g., *Segal* v. *Gordon,* 467 F. 2d 602 (2d Cir. 1972). The circuits have been consistent in their uniform application of rule 9(b) FRCP. The following representative decisions are in accord with the decision rendered in the instant case: *Wessel* v. *Buhler,* 437 F. 2d 279 (9th Cir. 1971); *Dayco Corp.* v. *Goodyear Tire and Rubber Company,* 523 F. 2d 389 (6th Cir., 1975); *Schaefer* v. *First National Bank,* 509 F. 2d 1287 (7th Cir. 1975) *cert. denied* 96 S. Ct. 1682; *Walling* v. *Beverly Enterprises,* 476 F. 2d 393 (9th Cir., 1973); *Seligson* v. *Plum Tree, Inc.,* 361 F. Supp. 748 (D.C. Pa., 1973) *reh. den.* 61 FRD 343; *Academic Travel Abroad, Inc.* v. *Kupper,* 54 FRD 576 (D.C. Wisc. 1972). In applying FRCP 9(b), the Courts below do not require evidentiary matter to be set forth in the complaint, but rather require averments setting forth the circumstances of the alleged fraud with particularity. *Segal* v. *Gordon, supra.* This is merely a rational implementation of congressional intent as set forth in FRCP 9(b).

The very first sentence of the complaint in the instant case, signals its insufficiency through the statement that each and every allegation is upon information and belief except paragraphs 1-10. (2a) The complaint is not accompanied by any statement of the facts upon which the belief is founded.[4]

In the first ten paragraphs of the complaint, the only allegations made with knowledge, refer to jurisdiction (¶ 1); claimed violations of §§ 12 and 17(a) of the Securities Act, and § 10 of the Exchange Act (¶ 2), as well as

[4] For this reason alone, as discussed below, the complaint should be dismissed.

other claimed violations of the securities laws, in the sale of limited partnership interests through Stonehenge, which alleged violations are not in issue on this appeal; venue (¶ 3); the appropriateness of class action certification under Fed. R. Civ. P. 23 (¶ 4); the applicability of the factual allegations to all plaintiffs (¶ 5); the composition and common interests of the class (¶ 6); the identity of the plaintiffs and the limited partnerships in issue (¶ 7); assertions by plaintiffs of their commencement of the action as a class action (¶ 8); identification of the specific purchases by Crane, and the dates and amounts of those purchases (¶ 9), and allegations that sales and solicitations were made by use of the mails (¶ 10).

All of the remaining allegations, as summarized below, are pleaded on information and belief.

The complaint alleges that Stonehenge organized limited partnerships as real estate syndications which were offered and sold to the public; that Stonehenge, Constantine and Ward were general partners and that Constantine, Ward and Henderson were officers and directors of Stonehenge (¶ 11 (a)); that Garfinkle sold the properties acquired by the limited partnerships, became the "wrap around mortgagee" and was able to misappropriate mortgage payments; that he conspired with Stonehenge, Constantine, Ward and Henderson, and that he "was aided and abetted by the other defendants herein" (¶ 11(b)). There follows a description of defendants Grayson Securities and Grayson (¶ 11(c)) and Donald Lawrence, Esq. (¶ 11(b)).

The complaint then describes the purpose of the three limited partnerships—to acquire and operate real estate (¶ 11a)—and claims that the organization, operation and sale of the limited partnerships were steeped in fraud

and deception and that the fraud led to an S.E.C. injunction against such practices (¶ 12). The complaint *carefully omits* the uncontested fact that the S.E.C. never took action against or enjoined any of the professional defendants.

Paragraphs 14 and 15 constitute the nub of plaintiffs' complaint. They restate the theme found in the amended and original complaints and in Appellants' Brief.[5] Both paragraphs reveal that the claim against appellees is based on supposition, surmise and speculation—not fact. Plaintiffs claim, in *res ipsa loquitur* fashion, that the fraud in the sale of the limited partnerships "could not be perpetrated without the services and cooperation of professionals such as defendant accountants and lawyers" (¶ 14); that "[a]t the very least, there were highly supicious circumstances [that] should have been investigated" (¶ 15); and that the "defendant accountants and lawyers shut their eyes to those circumstances, and made no inquiry into them, and made no disclosure, and thereby aided and abetted the deceptive concealment worked on Crane and the other investors." *Id.*

The manner in which the fraud occurred is set forth following allegations that relevant information was concealed from plaintiffs (¶ 16); that limited partnership interests were offered to numerous investors in various states; that substantial monies were realized on such sales (¶¶ 17, 18), and that the S.E.C. had asserted a requirement for registration prior to such sales (¶ 19).

The complaint then lists a litany of supposed facts and events which all of the defendants "knew or should have known" or "willfully and recklessly disregarded," and as

[5] (App. Br. 6).

to which there was no disclosure. *It is noteworthy that all of these allegations involved acts, misrepresentations and omissions of Stonehenge, its officers and Garfinkle. None involved any of the professional defendants.*

The allegations are that appellees should have known of the requirements asserted by the S.E.C. (¶ 20); that the sale of the limited partnership interests constituted unlawful sales of securities (¶ 21); that the properties acquired by Stonehenge from Garfinkle involved collusion and the absence of arm's length negotiations (¶ 22); that Garfinkle had a criminal record (¶ 23); that although the securities were offered as "tax shelter investments" in honestly managed entities, the real properties were acquired, sold and managed for the benefit of Garfinkle, Stonehenge and its officers (¶ 24); that Garfinkle obtained properties for little or no cash, or by placing junior mortgages against the properties (¶ 25); that Stonehenge paid Garfinkle substantially more for the properties than he had paid (¶ 26); that Stonehenge assumed various mortgages with the effect that the properties produced insufficient cash flow for debt service (*id.*); that by using a "wrap around mortgage" granted to Garfinkle, he controlled the manner in which junior mortgages were paid (¶ 27); that no escrow fund was set up (¶ 28); that Stonehenge exercised no control over the properties, and that Garfinkle misappropriated funds earmarked for the payment of mortgages (*id.*); that Garfinkle controlled the management and operation of the properties through certain agreements and arrangements (¶ 29); that Stonehenge prepaid certain interest payments to Garfinkle which he did not use to pay junior mortgages (¶ 30); that the properties purchased by plaintiffs were being foreclosed or had been foreclosed, and that the plaintiffs had suffered serious

financial losses (¶ 31); that the properties were poorly managed (¶ 32); that the limited partnerships were poorly managed and their funds wasted (¶¶ 33, 34); that Stonehenge and its officers accepted information from Garfinkle on the properties without independent verification which information Stonehenge in turn relied on and used for the purpose of soliciting investors (¶ 35); and that Stonehenge issued literature that referred to non-existent financing possibilities (¶ 36). Once again we pause to emphasize that all of these charges, whether or not they are true, have absolutely no relationship to any acts taken by the professional defendants.

Paragraph 37 of the complaint makes plain that the professional defendants played no part in the solicitation or sales of securities, and that they never distributed any offering brochures; that was done by Stonehenge, its officers and its sales representatives. Plaintiffs merely state, generally that the efforts of Stonehenge were "aided and abetted" by "defendants Barth, Bergmen and Barth, Pierson Duel & Holland and Ritch, Greenberg & Hassan." (¶ 37)

Although paragraph 37 lists all of the ways in which the sales efforts and circulars were alleged to be false and misleading *there is not the slightest specification of how the professional defendants are claimed to have aided and abetted.* The most that plaintiffs ever said is that the professional defendants shut their eyes to those circumstances, made no inquiry and made no disclosure (¶ 15), and the general allegations in paragraph 41 that *all* of the professional defendants prepared *all* of the offering brochures for *all* of the investments in Reading Easton, Carlene and Clementon.

Plaintiffs sought to detail their purported claims against Hassan in the second count of the complaint (¶¶ 42-67). These allegations also parrot the previously discussed conclusory allegations of paragraphs 7 through 41.

This claim begins with the allegation that a partner in the Hassan firm acted within the scope of his authority and that the Hassan firm rendered a variety of accounting services for Stonehenge (¶¶ 43-44).

Plaintiffs then allege that Hassan performed accounting services for Stonehenge (¶ 45) and that "as the accountants should have inquired into and disclosed . . . the misleading omissions and statements alleged in pars. 11 through 41" (*Id.*);" plaintiffs further alleged that Hassan knew or had reasonable grounds to suspect the blatant deceptions being worked by Stonehenge, et al., including the circumstances through which the partnerships obtained their properties, the arrangements made with respect to the properties, how those partnerships were being operated, what was happening to the funds that came from investors and that Hassan "consciously cooperated in keeping those facts concealed." (¶ 46)

The complaint further alleges that Hassan prepared financial statements for Stonehenge for at least the years 1971 through 1974 (¶ 47) and that brochures were distributed to the public, including Plaintiffs, to induce them to invest (¶ 48).

It should be noted that plaintiffs nowhere allege that Hassan issued *certified statements* or that Hassan had any knowledge that the uncertified statements which were prepared would be issued to prospective purchasers of partnership interests.

Plaintiffs then repeat in shopping list fashion all of the various "facts" set forth in Count 1 of the complaint (¶¶ 20-

37(k)) which "should have been included in those brochures [and which] the Hassan firm willfully or recklessly failed to do." (¶ 49)

Conspicuous by its absence is any allegation that Hassan knew of and intentionally sought to hide any of the alleged wrongs.

The Complaint further alleges that the financial statements which were included in the brochures failed to disclose any of the "facts" (¶ 50); that the financial statement contained inaccurate and artificially created figures obtained from Garfinkle which were not verified by Hassan and which did not represent actual or historic information and which were deceptive and misleading (¶ 51-52); that the financial statements concerning projections of income, cash flow and profit, etc. were prepared by Hassan and distributed to prospective investors (¶ 53); that neither Stonehenge nor the partnerships kept books in accordance with good bookkeeping practice or accepted accounting principles and that Hassan knew this but failed to disclose it (¶ 54); that Hassan knew but failed to disclose commingling of funds (¶ 55); that Hassan reviewed and participated in the preparation of sales brochures distributed to prospective investors and made no attempt to disclose the foregoing information (¶ 56); that Hassan knew there would be no S.E.C. registration, although it was required and Hassan deliberately omitted this information from the circular (¶ 57).

Plaintiffs further claim the alleged omitted or misleading statements in the brochure were material and relied on by them in making their purchase (¶¶ 58-59) *but,* plaintiffs do not allege what it was that made the alleged omissions and misstatements material, nor do they state how they relied

on the financial statements, nor do they allege that Hassan knew "about the fraud to be committed and *knowingly* rendered positive aid to it." *Frazier* v. *Stellar Industries, Inc., supra* 72 Civ. 2829 (D.C. Cal. Nov. 15, 1973 p. 24 of slip opinion); *Keene Corp.* v. *Weber,* 394 F. Supp. (787, 790) (SDNY 1975).

Plaintiffs also allege that Hassan violated certain AICPA rules and standards (¶ 60); specifically it is alleged that the purported statements should have contained an expression of opinion but did not (¶ 61); that Hassan obtained its information from Garfinkle and that this information should have been disclosed since AICPA rules require an auditor to disclose that he is making reference to the report of another auditor (¶ 62); that the use of the words "unaudited" or "pro forma" did not justify misleading omissions (¶ 63); that Hassan should have revised the statements when it became aware of its deficiencies (¶ 64); that Hassan should have advised the S.E.C. of the statements' alleged deficiencies (¶ 65); and that Hassan aided and abetted the alleged fraud (¶ 66 and 67).

We respectfully submit that this Court need look no further than the discussion in *Lanza* v. *Drexel & Co.,* 479 F.2d 1277 (2d Cir. 1973), and the opinion of the Ninth Circuit in *Wessel* v. *Buhler,* 437 F.2d 279 (9th Cir. 1971), to dispose of appellants' claim against Hassan.

In one way or another all of the foregoing seek to connect Hassan to financial statements which are purportedly false. However, as Judge Metzner noted in his opinion:

> "Those financial statements, attached to the Complaint as Exhibits A, B, C, were neither certified by [Hassan] nor identified with Hassan in any way" and "a reading of [the statements] shows that the alleged omis-

sions were not required to be included in order to make them complete for their intended purpose." (102a-103a)

Thus, in this case, as in *Gold* v. *DCL Inc.*, 399 F. Supp. 1123 (SDNY 1973), we respectfully submit that even if the complaint did contain an allegation by which it might be inferred that Hassan had knowledge of the facts as plaintiffs allege, there is nothing before this Court which possibly lead to a finding that there exists between Hassan and plaintiffs "the kind of special relationship which has heretofore imposed on auditors a duty of disclosure." 399 F. Supp. at 1127.

It is abundantly clear from the foregoing that appellants' goal was to sue anyone remotely connected with Stonehenge. It is even clearer that appellants have failed to satisfy the pleading requirements of Fed. R. Civ. P. 9(b).

Plaintiff's reliance on *U.S.* v. *Natalie*, 527 F. 2nd 311 is misplaced in view of the fact that Natalie involved criminal charges against an accountant who knowingly issued false and misleading financial statements. In any event it is indeed ironic that Plaintiff relies on a Second Circuit case for the proposition of the Second Circuit misapplies the requirements of Rule 9(b).

None of the cases relied on by petitioner has any bearing upon the issue before this Court, that is, whether or not certiorari should be granted. Indeed, they serve only to emphasize that this case has no importance beyond the particular facts and parties involved. It is impossible to discern in the petition before this Court any question of significance in terms of interpretation of any federal statute or the administration of the federal courts. The

petition fails completely to set forth any considerations of the character enumerated in Rule 19 of this Court which traditionally have influenced the Court to grant certiorari.

CONCLUSION

For the reasons stated, the petition for a writ of certiorari should be denied.

Dated: New York, New York
June 16, 1978

Respectfully submitted,

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